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Lessons of War Cost Finding

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DURING the nineteen months—April 1917, to November 1918—during which the United States was a belligerent in the World War, American industry and finance passed through an ordeal that brought both strength and weakness into sharp relief. Before this nation could strike its full stride, things were reduced to rather elemental and primitive terms. Much of mystery and of pretense was swept away. Out of it all must come to those in varied pursuits and walks of life, a charity and understanding, one with the other, based on fuller knowledge.

During these nineteen months the Federal Trade Commission had a peculiar opportunity to sense what was going on, especially in the industrial world. It has been the cost-finding agency of the government; the expert accountant of the War Industries Board and its Price Fixing Committee, to the Army, the Navy, the Food Administration, the Fuel Administration, the Railroad Administration, the Shipping Board, the Post Office and other agencies.

It is to be remembered that cost finding and price fixing were two entirely different functions. One was a striving for exact fact through painstaking study and labor; the other, building on this fact foundation, was a matter of discretion, of judgment, of accommodation to seen and unseen forces and an effort to distribute equitably the hardships inevitably resulting from the dislocations of war.

In its cost-finding work the Federal Trade Commission of necessity had to search into the very vitals of industry. Some took this as a matter of course, appreciating at once the end in view. For some other industries, however, such intrusion into the privacy of business was met at first with reluctance and misgivings. For the latter this attitude quickly changed, however, and these industries also welcomed and aided the commission in its work. At the end it can be said that there remains no sus-

picion that a single business secret has been betrayed. Costs were secured from whole industries—sometimes involving in a single inquiry the examination of the books of thousands of companies. These results were brought together and presented without disclosing the identity of individual figures except to the responsible officers of the government, and after opportunity for scrutiny by each concern of the processes and results as to its individual case.

Thus came confidence and understanding where impersonal discharge of duty was met with candor. The vast majority of patriotic and enlightened men of affairs welcomed every effort to steady and stabilize industry as it gathered its vast powers to ride the red seas of war and to deliver the tremendous blow against the enemy.

Before this country entered the war, and, therefore, before war powers could be exercised in control, a huge and false price structure was built up, and in spite of all that could be done, became more aggravated. Cost of living and wages went upward as prices rocketed. Price structure and its attendant inflations today are among the chief perils of the reconstruction period. That they are no greater can be attributed almost wholly to the coöperation of industry in the program of price fixing which checked, so far as possible, mounting prices, and, for the time, negatived price based solely on supply and demand.

One great handicap lay in the fact that basic natural resources had been appreciated in value before the price-fixing function came into operation. European belligerents had for three years been bidding, frantically, for the treasures that nature had placed under our stewardship, and as a result our raw materials had been hugely written up before the United States entered the war. So when price fixing was undertaken it started from inflated values for undug ores and coal, untouched petroleum and uncut forests. Despite this false start and the difficulties that flowed therefrom, cumulating in all subsequent industrial operations, price fixing did stabilize industry and insured it against ruinous collapse at the end of the war.

It is estimated that, in its work for various government agencies, the Federal Trade Commission obtained cost and production figures of upwards of 10,000 companies, in scores of important

industries and many minor ones, which had an approximate aggregate investment of twenty billion dollars, and the commodities directly affected by such cost findings represented annual sale values of at least thirty billions of dollars,—not far from twice the amount of the first, second and fourth liberty loans taken together. These cost studies by the Commission demonstrated frequent and great deficiencies in the accounting methods employed by mining and manufacturing concerns and especially in cost-accounting methods. In some of the oldest and greatest industries there was not even an attempt at that determination of unit costs and profits by products which is essential, generally, to the safe conduct of industry. It is evident that where such cost accounting is not established it should be introduced and where it is defective it should be reformed. Inventories should be carefully kept; labor and material should be accounted for as used; indirect and overhead charges should be fairly allocated and proper allowance made for depletion and depreciation of resources and plants.

On the other hand, capital charges for construction should not be mingled with operating or production expense nor should there be introduced items of actual or imputed outgo such as income and profit taxes, depletion or appreciation of plant investments, or interest on capital owned. However, where complete records are kept, it is relatively easy to correct bad principles, reject improper items or introduce omitted ones. Inventories and records of expense and sales by products are necessary to compute profit and loss by products.

The business world, well aware of the extent to which defective cost-accounting methods prevail, is alert to promote reforms. A few years ago the Federal Trade Commission initiated an effort to be helpful in this direction and applied to Congress for funds to carry it on. As these were not given the movement lagged, but, as a result of the Commission's enforced studies and as a by-product of its war work, that effort may well be profitably and economically resumed. If the earlier effort of the commission could have gone forward before the war, the government would have been repaid many times over during the war through making it possible to ascertain costs much more expeditiously and cheaply.

In the immediate future the question of costs will be especially critical for the nation's business in arriving safely at post-war readjustments. The matter is important to the individual producer, to his banker and to the industry and the public at large.

The cost and profit findings of the Commission developed many facts of interest but were prepared under such pressure that there has been little time as yet to analyze or interpret the results. Two facts, however, which are generally known, may be mentioned. First, the average cost during the war period was much higher than before the war. Such increases were frequently as much as 100 per cent. Second, the variation in costs between different companies, often considerable in normal times, was enormously exaggerated under war conditions.

The great increase in average cost was due in part to increase in cost of the instruments of production and material and supplies; to increased cost of labor partly through increase in wages but more through violent and frequent shifting of labor and a consequent loss of the efficiency that springs from organization, habit of work and special skill; to wastes caused by effort for increased production and, of course, to the general depreciation of money in terms of goods or services. The cost of living continued to mount rapidly and with it wages and labor cost.

Fundamental to the cost increases, however, was the writing up of values of natural resources. This tended to bring about the production of raw materials from relatively barren or inaccessible sources with a consequent diversion of labor, capital and transportation to uneconomic operations. It is doubtful whether high prices did really stimulate production to the degree that has generally been believed.

Where there were successive stages of production in an industry (sometimes integrated and sometimes independently operated) the costs were increased by the taking of high profits between the successive stages of production. High costs or high profits, or both, in one stage had a cumulative effect on costs in all succeeding states—a sort of pyramiding of cost. Price fixing, arriving too late to get at the source of the trouble in the short space of the war, was useful in checking its unlimited extension.

The abnormal variation in costs came largely from the bringing in of uneconomic supplies of raw materials and the writing up

in value of advantages by integrated concerns and those controlling natural resources. Congested transportation and dislocations of labor with the consequent irregularity of industrial operations also made for wide cost variations.

In considering such variations, however, it should be borne in mind that the lower cost company may not be more profitable than the higher cost producer even when both sell at the same price. Often the lower cost is the result not of greater economies or natural advantages but of investment in more stages of production or in more extensive mechanical equipment, and the larger unit profit resulting from the lower cost is absorbed in providing the proper return on the greater unit investment.

Not the least benefit of cost finding, incident to price fixing, was the bringing together, with government officers, of the representatives of the industries for full and frank discussion of costs, methods and products. This, with the assembling of such a body of current data as was never before had in this country, demonstrated the value of such meetings and of the preparation and exchange of such proper and useful information. It would seem that the Commission might well continue, at least as to certain industries, this assembling and distribution, currently, of basic and reliable information and that, well within the law, industry meeting with government officers might continue to exchange helpful experiences and information without the danger of being suspected of price fixing or other restraints of trade.

If certain laws, enacted to deal severely with admitted abuses, are fully observed in their spirit, in this manner, it would seem that the public interest would be fully served. In such case, a peace-time adaptation of the war-time meetings between individuals and government for frank discussion, would be as helpful as it would be innocent of wrong intent or harmful effect. Such open conferences might be expected to serve all the good and necessary ends which are among those sometimes sought by clandestine meetings. Pursued in the generous American business spirit of fair play such conferences might be extremely useful by ascertaining the facts and clearing away doubts and suspicions.

From the experience of cost finding, we believe we may argue for:

- (1) Standardized accounting systems, suited to the various industries.
- (2) Cost and profit accounting for individual products.
- (3) Reasonable standardization of products and elimination of excessive costs due to unnecessary multiplication of styles and types.
- (4) Compilation and issue of current, basic trade information.
- (5) Conferences between industries and government for the exchange of proper and useful views and information.

As for the outlook there need be foresight but no fear. A period of readjustment must be met with the new and broader view. The same coöperation of industry, of labor, of capital and of government that armed the nation for war will make it still greater in peace.

As a nation we organized lines of supply and communication from Chile and Australia and Alaska and from every state and every farm and factory, and through these lines across oceans and continents to the battle front of France. As a nation we arrived at a power to dispatch a ship loaded with men and food and supplies, on the average, of every ten minutes night and day, Sundays and holidays. As a nation we launched ships at the rate of 490,000 gross tons a month—about 700 tons every hour, on the average. As a nation we armed and sent across the sea our young men, true crusaders of democracy, at the rate of 10,000 a day. As a nation we threw upon liberty's altar billions and billions in loans—about \$500 at every tick of the clock, day and night, Sundays and holidays.

Such a nation, as a nation, may turn with confidence to the solution of whatever problems of industry or finance which the future may hold in store.